

REPORT OF EXAMINATION  
OF THE  
SAN DIEGO INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2004

Filed June 30, 2006

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Los Angeles, California  
April 10, 2006

Honorable John Garamendi  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**SAN DIEGO INSURANCE COMPANY**

(hereinafter also referred to as the Company) at its home office, located at 525 B Street, San Diego, California 92101.

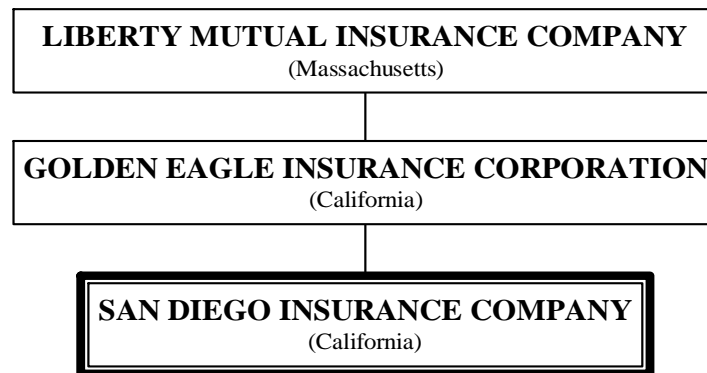
**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2004. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances. This examination was conducted concurrently with the examination of Golden Eagle Insurance Corporation, the Company's immediate parent.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; and sales and advertising.

**MANAGEMENT AND CONTROL**

The following abridged organizational chart, which is limited to the Company's parent, Golden Eagle Insurance Corporation along with its ultimate parent, Liberty Mutual Insurance Company, depicts the Company's relationship within the holding company system.



All ownership is 100%.

Management of the Company is vested in a six-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

#### Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Roger L. Jean Amherst, New Hampshire	President Liberty Regional Agency Markets
James F. Dore Boston, Massachusetts	Chief Financial Officer Liberty Regional Agency Markets
John D. Doyle Southborough, Massachusetts	Comptroller Liberty Mutual Insurance Company
Mark E. Fiebrink Amherst, New Hampshire	Executive Vice President Liberty Regional Agency Markets
Francis J. Kotarba Rancho Santa Fe, California	President and Chief Executive Officer Golden Eagle Insurance Corporation
Christopher C. Mansfield	Senior Vice President and General Counsel

Name and ResidencePrincipal Business Affiliation

Dedham, Massachusetts

Liberty Mutual Insurance Company

Principal OfficersNameTitle

Roger L. Jean

Chairman of the Board

Francis J. Kotarba

President and Chief Executive Officer

Steven N. Martin

Vice President, Finance and Treasurer

Timothy R. Lickness

Vice President, Legal and General Counsel

Mark E. Fiebrink

Executive Vice President

Management Agreements

Management Services Agreement: The Company entered into a Management Service Agreement with its ultimate parent, Liberty Mutual Insurance Company (LMIC) a Massachusetts insurer on August 21, 1997. LMIC provides management services to the Company. The services include, but are not limited to, investment advice, accounting, tax preparation, payroll, and employee benefits. The agreement specifies that the Company shall reimburse LMIC for the reasonable cost of performing any of these services. This agreement was approved by the California Department of Insurance (CDI) in June 2001.

Federal Tax Sharing Agreement: The Company and its affiliates are part of a consolidated federal income tax agreement with LMIC. Allocation of taxes is based upon separate return calculations with inter-company tax balances normally settled in the quarter subsequent to the filing of the consolidated return. This agreement was approved by the CDI on November 19, 2003, and an amendment was approved on January 23, 2006.

CORPORATE RECORDS

The Company's board actions regarding the authorization and approval of investments did not satisfy the requirements of California Insurance Code (CIC) Section 1201. The Company's minutes failed to document specific references to amounts, facts and the values of the securities as required under CIC Section 1201. It is recommended that the Company implement procedures to ensure future compliance with CIC Section 1201.

### TERRITORY AND PLAN OF OPERATION

The Company was formed on August 18, 1997 to run-off liabilities assumed from the Golden Eagle Insurance Company under an agreement that was approved by the Superior Court and County of San Francisco. The Company has no direct written premiums or losses. The liability for losses is maintained using deposit accounting as approved by the California Department of Insurance.

### REINSURANCE

#### Assumed

The Company has no reinsurance assumed.

#### Ceded

The Company has no reinsurance ceded.

## ACCOUNTS AND RECORDS

This examination experienced difficulties obtaining supporting documentation for much of the information reported by the Company in its filed Annual Statements. The difficulty results, in part, from the decentralized nature of the recordkeeping. It is recommended that the Company maintain documentation to support certain financial statement accounts. The documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Annual Statement to individual records.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders  
from December 31, 1999 through December 31, 2004

Statement of Financial Condition  
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 25,609,196	\$ 25,609,196	
Stocks:			
Common stocks	184,589	184,589	
Cash and short-term investments	43,187,091	43,187,091	
Receivable for securities	43,657	43,657	
Investment income due and accrued	511,429	511,429	
Federal income tax recoverable	<u>6,674,601</u>	<u>6,674,601</u>	
Total assets	<u>\$ 76,210,563</u>	<u>\$ 76,210,563</u>	
<u>Liabilities, Surplus and Other Funds</u>			
Losses		\$	(1)
Loss adjustment expenses			(1)
Net deferred tax liability		21,000	
Payable to parent, subsidiaries and affiliates		1,969,940	
Aggregate write-ins for liabilities		<u>18,607,777</u>	(2)
Total liabilities		20,598,717	
Common capital stock	\$ 2,600,000		
Gross paid-in and contributed surplus	52,800,000		
Unassigned funds (surplus)	<u>211,846</u>		
Surplus as regards policyholders		<u>55,611,846</u>	
Total liabilities, surplus and other funds		<u>\$ 76,210,563</u>	



Underwriting and Investment Exhibit  
for the Year Ended December 31, 2004

Statement of Income

Investment Income

Net investment income earned	\$ 2,905,689	
Net realized capital gains	<u>531,239</u>	
Net investment gain		3,436,928

Other Income

Net gain from agents' balances charged off	\$ 442,347	
Aggregate write-ins for miscellaneous income	<u>3,246,456</u>	
Total other income		<u>3,688,803</u>
Net income before federal income taxes		7,125,731
Federal income taxes incurred		<u>2,550,562</u>
Net income		<u>\$ 4,575,169</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 50,857,596
Net income	\$ 4,575,169	
Change in net unrealized capital gains	163,755	
Change in net deferred income tax	17,249	
Aggregate write-ins for gains and losses in surplus	<u>(1,923)</u>	
Change in surplus as regards policyholders		<u>4,754,250</u>
Surplus as regards policyholders, December 31, 2004		<u>\$ 55,611,846</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 1999 through December 31, 2004

Surplus as regards policyholders, December 31, 1999, per Examination			\$ 40,242,082
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net gain	\$ 13,560,522	\$	
Net unrealized capital gains	232,068		
Change in net deferred income tax		1,914,150	
Change in nonadmitted assets	3,493,248		
Aggregate write-ins for losses in surplus	<u>                    </u>	<u>1,923</u>	
Totals	<u>\$ 17,285,838</u>	<u>\$ 1,916,073</u>	
Net increase in surplus as regards policyholders			<u>15,369,765</u>
Surplus as regards policyholders, December 31, 2004, per Examination			<u>\$ 55,611,847</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Because the Company writes no premiums and services its existing liabilities for claims using only deposit accounts, there are neither loss nor loss adjustment expense reserves.

### (2) Aggregate Write-ins for Liabilities : Deposit Liability

The Company's deposit liability for unpaid claims as of December 31, 2004 was reviewed by a Casualty Actuary from the California Department of Insurance. The Company's reserve for the deposit liability was determined to be reasonable.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Corporate Records (Page 4): It is recommended that the Company implement procedures in its board meetings to ensure compliance with California Insurance Code (CIC) Section 1201.

Accounts and Records (Page 5): It is recommended that the Company maintain documentation to support all financial statement accounts. The documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Annual Statement to individual records.

### Previous Report of Examination

Corporate Records (Page 2): The Company had failed to present to the Board the prior examination report as required by California Insurance Code Section 735. The Company complied with this requirement upon presentation of the report to the Board on May 24, 2000.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Aram W. Shahenian, CFE  
Examiner-In-Charge  
Senior Insurance Examiner - Supervisor  
Department of Insurance  
State of California